

N.D.A.G. Letter to Person (Oct. 14, 1988)

October 14, 1988

Mr. Alan Person
Executive Director
North Dakota Public Employees
Retirement System
P.O. Box 1214
Bismarck, ND 58502

Dear Mr. Person:

Thank you for your August 26, 1988, letter in which you ask whether the Public Employees Retirement Board (Board) has any potential liability arising from its administration of the State's deferred compensation program under N.D.C.C. ch. 54-52.2. Your first inquiry concerns the Board's potential liability for the investment performance of the approved deferred compensation providers. Your second question is whether the Board, by establishing provider eligibility requirements and establishing a list of eligible providers, may be held liable for what could be perceived as an endorsement of those companies by the Board. I will generally discuss the State's deferred compensation Program prior to answering your questions.

The administration of the State's deferred compensation program is under the direction of the Public Employees Retirement Board. N.D.C.C. § 54-52.2-03. The Board is required to maintain the program in compliance with appropriate provisions of the Internal Revenue Code and regulations adopted thereunder. In accordance with its administrative authority over the deferred compensation program, the Board has adopted a Deferred Compensation Plan document, which sets forth the details of the program. In addition, the Board has authorized a standard Provider Administrative Agreement that must be signed by all providers. This agreement specifies the providers' responsibilities under the deferred compensation program. Although the Board imposes program responsibilities on the various providers, it has no statutory authority to exclude providers who are willing to sign the administrative agreement and abide by its terms.

N.D.C.C. § 54-52.2-01 provides that only insurance companies, federally insured financial institutions, the Bank of North Dakota, and dealers registered under N.D.C.C. ch. 10-04 may be deferred compensation providers. The Board maintains a list of eligible providers who have signed the administrative agreement and provides general information to State employees upon request. Employees desiring to participate in the program must sign a participation agreement which authorizes the monthly payroll deduction, indicates the employee's chosen provider, and names a beneficiary.

The Legislature has addressed the liability of the State under the deferred compensation program in N.D.C.C. § 54-52.2-07, which states as follows:

54-52.2-07. Liability under deferred compensation program. The financial liability of the state, county, city, or other political subdivision under a deferred compensation program is limited in each instance to the value of the employee's deferred compensation account, and the state, county, city, or other political subdivision is not responsible for any loss which may result from investment of the deferred compensation under the deferred compensation program.

On its face, N.D.C.C. § 54-52.2-07 is not entirely clear. It limits the State's liability to the value of the employee's deferred compensation account but also provides that the State is not responsible for any investment losses. The meaning of N.D.C.C. § 54-52.2-07 becomes clear only when one understands the ownership aspects of the deferred compensation accounts. Under 457 of the Internal Revenue Code (26 U.S.C. § 457), the deferred compensation account must be owned by the employer and can only be distributed to a participant upon separation of employment or if the employee is faced with an unforeseeable emergency. Accordingly, N.D.C.C. § 54-52.2-07 provides that the financial liability of the State is limited to the value of the employee's deferred compensation account, which would be determined on the date of a qualifying event. As N.D.C.C. § 54-52.2-07 further provides, however, the State is not responsible for any loss which may result from the investment of funds in the deferred compensation program.

In addition, paragraph 3.06 of the Deferred Compensation Plan document states as follows:

The Employer or Retirement Board shall not be required to invest assets nor be responsible for any loss due to the investment or failure of investment of funds and assets in said deferred compensation account, nor shall Employer or Retirement Board be required to replace any loss whatsoever which may result from said investments.

Paragraph 3.06 of the Plan document, in effect, disclaims any liability of the Board for the providers' investment performance.

Based on N.D.C.C. § 54-52.2-07 and paragraph 3.06 of the plan document, there appears to be no basis for which the Board or the State of North Dakota may be held liable for losses resulting from the investment of deferred compensation funds.

Your second question is whether the Board, by establishing provider eligibility requirements and establishing a list of eligible providers, may be held liable for what could be perceived as an endorsement of those eligible companies. As stated above, the Board cannot statutorily exclude providers who comply with the program's guidelines. Accordingly, the program's structure does not suggest that an endorsement is being made. Therefore, I find it very unlikely that the Board would be held liable under a "perceived endorsement" theory.

To further protect itself, the Board may wish to include a disclaimer in the participation agreement signed by the employee clearly stating that the Board does not endorse any of the eligible providers and is not liable for the chosen provider's investment performance. It is my understanding that the Board will be preparing a deferred compensation brochure that will be distributed to interested State employees. I recommend that this brochure also include a statement clearly disclaiming any responsibility of the Board for the employee's selection of an eligible provider and the provider's investment performance. Please feel free to contact our office for assistance in drafting these disclaimers.

In reviewing the Provider Administrative Agreement, I notice that it contains a provision that requires the provider to "hold harmless the Retirement Board for any loss, damage or expense arising in connection with any actions taken or omitted by the Provider." I recommend that the Board continue its practice of requiring the hold harmless provision in the administrative agreements inasmuch as it gives further protection to the Retirement Board.

Litigation against the Board may also be barred by the sovereign immunity doctrine. This defense is not available if the action is based on a contract theory. See N.D.C.C. § 32-12-02. Because the applicability of the sovereign immunity doctrine will depend on the facts of the case and the legal theory underlying the cause of action, it is not practical to engage in further discussion of this doctrine at this time.

Although it does not appear that the Board has any real legal exposure resulting from its administration of the deferred compensation program, I certainly cannot guarantee that the Board will never be held liable for its actions. Accordingly, in addition to my recommendations above, I urge you to exercise due diligence in administering the program.

If you have any further questions on this matter, please do not hesitate to contact me.

Sincerely,

Nicholas J. Spaeth

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